ARTICLE

The Green Transition: Tax Incentives and State Aid

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The article analyses the EU and European Economic Area (EEA) Member States' leeway under the state aid rules in Article 107 Treaty on the Functioning of the European Union (TFEU) and Article 61 EEA Agreement regarding the use of tax incentives to promote the green transition for which they currently have a more significant amount of discretion than before for doing so. There is an increased focus on the environment in the EU and the EEA, and the analysis proves that this would most likely entail that some tax incentives that would have been considered as unlawful under Article 107 TFEU/Article 61 EEA Agreement only a few years ago would currently be considered as compatible with the state aid rules.

Keywords: State aid, EU and EEA, tax incentives, the green transition, environment, tax, Paris Agreement, GBER, development, compete with non-EU states.

1 Introduction

This article analyses to what extent the state aid rules in the Treaty on the Functioning of the European Union (TFEU)[1] and the European Economic Area (EEA) Agreement[2] place any restrictions on a Member States' possibility to use tax incentives[3] to promote the green transition. If so, has there been a movement in the EU and the EEA towards accepting tax incentives promoting the green transition as lawful under Article 107 TFEU and Article 61 EEA?[4]

In 2015, 196 countries around the world adopted the historic Paris Agreement[5] thereby agreeing to reduce global warming and build resilience to climate change.[6] Its overall goal is to limit global warming to no more than 1.5 degrees Celsius. To achieve this by 2030, countries must reduce emissions by at least 45% compared to 2010 levels and reach 'net zero'[7] by 2050.[8] Like the UN, the EU has set out ambitious targets in an attempt to effectively address climate change and foster a cleaner environment, aiming for a 55% reduction in greenhouse gas emissions by 2030, and to become a climate-neutral continent by 2050.

To achieve the net-zero goal, there are several policy instruments available, and tax incentives may be one of those available to support the 'complete transformation of how we produce, consume, and move about'[9] that is needed.[10] This transformation will be expensive with

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1 Treaty on the Functioning of the European Union (EUR-Lex – 12012E/TXT – EN – EUR-Lex (europa.eu)) (accessed 1 Sep. 2024).

2 Agreement on the European Economic Area (AGREEMENT ON THE (efta.int)) (accessed 1 Sep. 2024).

3 *See* s. 1.2 for a brief explanation of term 'tax incentives'.

4 Article 107 TFEU and Art. 61 EEA stipulate the test for state aid in the EU and EEA, respectively. Although there are some differences in the wording of Art. 107 TFEU and Art. 61 EEA, the state aid rules in the TFEU and the EEA Agreement are substantially the same. There are, however, some procedural differences, but this will not be discussed in this article. In the following, it will only refer to the state aid rules in the TFEU insofar as there are no differences between the state aid rules in the TFEU and the EEA Agreement.

5 https://www.un.org/en/climatechange/paris-agreement (accessed 1 Sep. 2024).

6 The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 Parties at the UN Climate Change Conference (COP21) in Paris, France, on 12 Dec. 2015. It entered into force on 4 Nov. 2016.

7 'Net zero' means cutting greenhouse gas emissions to as close to zero as possible with any remaining emissions reabsorbed from the atmosphere by oceans and forests, for instance.

8 *See* https://www.un.org/en/climatechange/net-zero-coalition for a simplified explanation of the concept of 'net zero' (accessed 1 Sep. 2024).

9 https://www.un.org/en/climatechange/net-zero-coalition# (accessed 1 Sep. 2024).

10 *See* European Commission, *Directorate-General for Taxation and Customs Union* (2021). *Taxation in Support of Green Transition: An Overview and Assessment of Existing Tax Practices to Reduce Greenhouse Gas Emissions*: final report, 17 Publications Office, https://data.europa.eu/doi/10.2778/343194 s. 2.1 for a high level overview (accessed 1 Sep. 2024).

one estimate suggesting that the EU will need approximately EUR twenty-two trillion in investments from the private sector between 2021–2050 to achieve the goals of the green transition.[11] There are some estimates that only about 17–20% of this will come from public spending.[12] Others argue that the public-private ratio may be closer to 1:4 with some variation between eastern and western European countries.[13] 'Even without a precise number, most policymakers believe a "lion's share" of the investment must come from the private sector'.[14,15]

A considerable number of articles and books have been written about the interaction between tax incentives and the state aid rules in the TFEU. *See* for examples, P. Pistone & M. Villar Ezcurra eds, 'Energy Taxation, Environmental Protection and State Aids: Tracing the Path from Divergence to Convergence' (2016) with a detailed analysis of tax incentives aimed at environmental protection and state aid. *See also* Edoardo Traversa, 'Tax incentives and territoriality within the European Union: balancing the internal market with the tax sovereignty of member states', World Tax Journal October 2014, page 321; Wolfgang Schön, 'Taxation and State Aid Law in the European Union', Common Market Law Review, Vol. 36, No. 4, 1999, pages 911–936, and Isabelle Richelle, Wolfgang Schön, and Eduardo Traversa (Eds), State Aid Law and Business Taxation, Springer, 2016.

Further, a substantial number of articles and books have been written about green taxation. *See* for example, P. Pistone & M. Villar Ezcurra eds, 'Energy Taxation, Environmental Protection and State Aids: Tracing the Path from Divergence to Convergence' (2016) that cover issues related to green taxation in addition to tax incentives and state aid.

Although a considerable amount of literature has been written on green taxation and the interaction between tax incentives and state aid, this issue still needs to be analysed. This applies because there has been and is an increasing focus on sustainability and the environment, including the green transition, in EU in the later years. Hence, it is interesting to *see* whether this latest development influences the interpretation of whether a domestic tax incentive is considered as lawful under Article 107 TFEU.

2 Tax incentives[16]

The drafting and design of tax incentives varies considerably and, further, tax incentives can be introduced for a range of reasons. For example, they can be used to promote certain activities, sectors, or investments in public goods or in specific geographic locations. Further, tax incentives can be 'used to address certain market failures and encourage investments that bring positive spillovers to the rest of the economy'.[17] Hence, they may be used to promote and attract economic activity in their jurisdictions such as, for example, research and development (R&D) and innovation, in high-technology industries, or to support the green transition.[18] Such encouragement may be given both in the form of beneficial tax treatment, e.g., in the form of a lower tax rate or a lower tax base, or a more burdensome tax treatment in the form of, e.g., higher tax rates and/or a higher tax base.

Furthermore, tax incentives can also be used to attract foreign direct investment (FDI). This represents a key source of external finance for development that can bring capital, technology, and know-how to the jurisdiction. These can bring positive spillovers to the domestic economy in certain circumstances.[19]

A common definition of 'tax incentives' is something similar to this: 'A tax incentive is a government measure that is intended to encourage individuals and businesses to spend money or to save money by reducing the amount of tax that they have to pay'.[20] In the author's view, however, it is not necessary to have a strict definition of the term for analysing to what extent the state aid rules in the TFEU and the EEA Agreement put any restrictions on a Member States' possibility to use tax incentives to promote the green transition. The evaluation of their compatibility with EU and EEA law is, in any case, a

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11 https://taxfoundation.org/research/all/eu/eu-green-transition-tax-policy/#tax (accessed 1 Sep. 2024).

12 European Commission, *Investment Needs Assessment and Funding Availabilities to Strengthen EU's Net-Zero Technology Manufacturing Capacity* (23 Mar. 2023), https://single-market-economy.ec.europa.eu/system/files/2023-03/SWD_2023_68_F1_STAFF_WORKING_PAPER_EN_V4_P1_2629849.PDF (accessed 1 Sep. 2024).

13 Zsolt Darvas & Guntram Wolff, *A Green Fiscal Pact: Climate Investment in Times of Budget Consolidation* Bruegel 18 (Sep. 2021), https://www.bruegel.org/sites/default/files/wp_attachments/PC-2021-18-0909.pdf (accessed 1 Sep. 2024).

14 https://taxfoundation.org/research/all/eu/eu-green-transition-tax-policy/#tax (accessed 1 Sep. 2024).

15 European Council, *Channeling Europe's Savings into Growth' – Op-ed article by European Council, European Commission, Eurogroup, ECB and EIB Presidents* (9 Mar. 2023), https://www.consilium.europa.eu/en/press/press-releases/2023/03/09/channeling-europe-s-savings-into-growth-op-ed-article-by-european-council-european-commission-eurogroup-ecb-and-eib-presidents/ (accessed 1 Sep. 2024).

16 The OECD has an Investment Tax Incentives Database (ITID) that provides insights into tax incentives in fifty-two emerging and developing economies, including how incentives are designed and granted to investors, https://stats.oecd.org/Index.aspx?DataSetCode=RDTAX (accessed 1 Sep. 2024).

17 OECD, *Tax Incentives and the Global Minimum Corporate Tax: Reconsidering Tax Incentives after the GloBE Rules*, OECD Publishing, Paris 11 (2022), https://doi.org/10.1787/25d30b96-en (accessed 1 Sep. 2024), para. 6.

18 *Ibid.*

19 *Ibid.*

20 TAX INCENTIVE definition and meaning | Collins English Dictionary (collinsdictionary.com) (accessed 1 Sep. 2024).

case-by-case evaluation for which the facts and circumstances of the tax incentive must be evaluated against the EU and EEA law. Hence, a general definition itself is not decisive.

When discussing using tax incentives to promote the green transition, it is important to take into account that some are of the opinion that '[t]ax incentives are but one – and probably the least important – instrument to further environmentally beneficial behaviour and decisions. The existing theoretical and empirical literature suggests that fiscal incentives, in particular grants, direct subsidies, and preferential loans, are more prevalent than tax incentives'.[21] Although tax incentives are likely not the key driver to the green transition, it may be one out of more instruments that can be used to achieve the Paris Agreement's goal to limit global warming to 1.5 degrees and reach 'net zero' by 2050.[22] Further, although the effect of tax incentives is disputable, '[T]ax incentives are widely used among developed and developing economies to promote and attract economic activity in their jurisdictions'.[23]

Under the analysis of the use of tax incentives to promote the green transition, it is necessary to briefly comment on 'green taxation'. This is often referred to as the *imposition of taxes and other fees* on activities, products, or services that harm the environment (and thus the opposite of tax incentives to some extent). The purpose of green taxation is to generally encourage individuals and businesses to adopt environmentally friendly practices, reduce waste and pollution, promote sustainable development, and mitigate climate change. Green taxes may be applied to various sectors including energy, transportation, waste disposal, and agriculture, among others. Examples of them include taxes on carbon emissions, plastic bags, and landfill waste as well as incentives for renewable energy and energy-efficient technologies. Hence, the term 'green taxation' is relatively broad and may cover not only direct taxation but also indirect taxation and duties.[24]

The scope of this article limits the possibility of discussing all aspects of using taxes to promote the green transition. The article aims at tax incentives and not on the imposition of taxes and other fees.[25] Hence, green taxation is thus beyond the scope of this article and will not be further analysed.

3 Outline

This article is organized as follows. In section 2, there is an explanation of the term 'tax incentives' in this article to ensure that the author and the reader are in agreement regarding the understanding of the scope of the article. Further, section 4 analyses the potential limitation that follows from the state aid rules in the TFEU, including whether there has been a shift in direction of more acceptance for using tax incentives to promote the green transition. The final section of this article is section 5 that comments on what may be expected in the future regarding whether there has been a movement in the EU and the EEA towards accepting tax incentives promoting the green transition as lawful under Article 107 TFEU and Article 61 EEA.

4 EU/EEA law

4.1 *Introduction*

The issue of the interaction between EU/EEA law and domestic tax incentives rules may be analysed from various angels. The four fundamental freedoms, the state aid rules, and the EU Code of Conduct (business taxation)[26] are all relevant to consider.[27] There is an overly wide range, however, for this article to analyse tax incentives aimed at promoting the green transition in relation to these three sets of rules. It will instead focus on the interaction with state aid rules only. In a communication from the Commission from 2022 C(2022) 481 Guidelines on state aid for climate, environmental protection and energy 2022, it highlighted that the '[s]tate aid rules in particular, has an important role to play in enabling and supporting the Union in fulfilling its Green Deal policy objectives'.[28]

Section 4.2.1 to section 4.2.4 briefly examine the basic framework for state aid under EU law, including the later development of the framework. The aim of these sections is to be able to analyse whether the later development of the state aid framework entails that the Member States have been granted more discretion for implementing domestic tax incentives with the aim to promote the green transition.

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21 European Commission, *supra* n. 10. *Taxation in Support of Green Transition, supra* n. 10, at 51.

22 *See* https://www.un.org/en/climatechange/net-zero-coalition for a simplified explanation of the concept of 'net zero' (accessed 1 Sep. 2024).

23 *Supra* n. 17, s. 2.1 para. 6.

24 https://taxation-customs.ec.europa.eu/green-taxation-0_en (accessed 1 Sep. 2024).

25 For an informative overview of the EU and green taxation, *see* https://taxation-customs.ec.europa.eu/green-taxation-0_en with further references (accessed 1 Sep. 2024).

26 https://www.consilium.europa.eu/en/council-eu/preparatory-bodies/code-conduct-group.

27 *See* Yvette Lind, *The Fundamentals of Tax Incentives*, Skatterett 2023 15–38 (s. 3.3) for a high-level overview of the interaction between domestic tax incentives and the limitation that follows from EU law,https://doi-org.ezproxy.library.bi.no/10.18261/skatterett.42.1.3 (accessed 1 Sep. 2024).

28 C(2022) 481 final para. 4. Guidelines on state aid for climate, environmental protection and energy 2022.pdf (eftasurv.int).

4.2 *State Aid*

4.2.1 *In General: When Is a Tax Incentive Aimed at Promoting the Green Transition Lawful?*

A company receiving government support in the form of a tax incentive, for example, may gain a distortive advantage over its competitors. Therefore, Article 107 TFEU generally prohibits state aid unless exceptionally justified.[29,30] Despite it generally being prohibited in Article 107 TFEU, in some circumstances, government interventions are necessary for a well-functioning and equitable economy. Therefore, the TFEU affords a greater margin of freedom regarding a number of policy objectives for which state aid can be considered compatible.[31] In relation to the question of using tax incentives to promote the green transition, the question is whether they promote policy objectives that are compatible with the state aid rules.

Article 107 TFEU may be divided into three parts. Paragraph (1) includes the general principle that state aid is incompatible with the internal market. Article 107 (1) TFEU includes six conditions that must all be met before state aid falls under paragraph (1):

(1) There must be an advantage conferred on the recipient.
(2) The aid must be granted by a Member State or through state resources.
(3) The recipient must be one or more undertakings that carry out an economic activity.
(4) The measure must favour certain enterprises (be selective).
(5) The aid must distort or threaten to distort competition.
(6) The aid must have an effect on inter-state trade.

There is extensive case law from the CJEU regarding these six requirements.[32] In relation to tax incentives aiming at accelerating the green transition, the selectivity requirement (number 4) is the most relevant one to discuss.

Article 107 (2) TFEU includes some exemptions from the general principle in paragraph (1) and excludes some forms of aid measures that will be deemed to be compatible with the internal market. Further, paragraph (3) lists types of cases for which the state aid may be deemed to be compatible with the internal market.[33] The six requirements included in Article 107(1) TFEU and the exemptions in paragraphs (2) and (3) must all be interpreted on an individual basis (i.e., on a case-by-case basis) to be able to determine whether a tax incentive aiming at promoting the green transition is contrary to the EU state aid rules.[34]

If a Member State wants to implement a new state aid measure, Article 108(3) TFEU requires it to notify the European Commission and to implement it only after its approval.[35] However, a general block exemption from the state aid rules was implemented in 2008 and reformed in 2014[36] and 2023 through Commission regulation (EU) 2023/1315 of 23 June 2023.[37] The Enabling Regulation[38] enables the Commission to adopt what is known as a General Block Exemption Regulation (GBER) for state aid and declare certain categories of it to be compatible with the internal market.[39] The GBER allows Member States to implement certain aid measures directly with legal certainty without notifying the Commission (and wait for an answer) when the benefits to society outweigh the possible distortions of competition. As a result of the GBER, more than 90% of all new state aid

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[29] State aid is defined as an advantage in any form whatsoever conferred by national public authorities to undertakings on a selective basis. Therefore, subsidies granted to individuals or general measures open to all enterprises are not covered by this prohibition and do not constitute state aid (examples include general taxation measures or employment legislation).

[30] For a detailed analysis of the interaction between state aid rules and tax incentives, *see* Edoardo Traversa, «*Tax Incentives and Territoriality Within the European Union: Balancing the Internal Market With the Tax Sovereignty of Member States*», World Tax J.l 321 (Oct. 2014), doi: 10.59403/mfddv0; Wolfgang Schön, «*Taxation and State Aid Law in the European Union*», 36(4) Common Mkt. L. Rev. 911–936 (1999), doi: 10.54648/239680, and *State Aid Law and Business Taxation* (Isabelle Richelle, Wolfgang Schön & Eduardo Traversa eds, Springer 2016), https://doi-org.ezproxy.library.bi.no/10.1007/978-3-662-53055-9 (accessed 1 Sep. 2024).

[31] https://competition-policy.ec.europa.eu/state-aid/overview_en (accessed 1 Sep. 2024).

[32] There is a significant number of cases from the CJEU dealing with one or more of these six conditions. *See* e.g., Cases C-487/06 P, C-74/16, and C-203/16. The aim of this article, however, is not to comprehensively analyse the scope of these six requirements, including their relevant case law, since there is not a single tax incentive i.e., analysed in relation to the state aid rules but more tax incentives promoting the green transition in general.

[33] Craig & de Búrca, *EU Law. Text, Cases and Materials* 1164 (7th ed.).

[34] However, TFEU Art. 107 (2) and (3) may only be applied by the EU Commission.

[35] In addition to the material issues related to state aid, 'enforcement of State Aid law is an essential part of a successful competition policy'. (Craig & de Búrca, *supra* 33, at 911.) It is outside the scope of this article, however, to discuss these procedural and enforcement rules. For an overview of the state aid procedural and enforcement rules, *see* e.g., Craig & de Búrca, *supra* n. 33, s. 22.4 with further references.

[36] Through Regulation (EU) No 651/2014 of 17 Jun. 2014.

[37] This regulation is also applicable under the EEA Agreement.

[38] Council Regulation (EU) 2018/1911 of 26 Nov. 2018 amending Regulation (EU) 2015/1588 on the application of Arts 107 and 108 of the Treaty on the Functioning of the European Union to certain categories of horizontal state aid.

[39] With these regulations, the Commission can declare specific categories of state aid compatible with the treaty if they fulfil certain conditions thus exempting them from the requirement of prior notification and Commission approval.

measures excluding crisis measures are now implemented by Member States without the need for prior approval from the Commission.[40]

In general, the 'GBER is aimed at a wide range of aid measures that are considered less problematic in competition terms, i.e., less distortive'.[41] Twenty-six main areas of aid are covered by it, including aid for environmental protection and aid for research, development, and innovation (RDI). Hence, the GBER is especially relevant in relation to the question of the compatibility of domestic tax incentives aimed at promoting the green transition in relation to the state aid rules.

In the latter years, there was a process in the Commission to amend and adjust the GBER to simplify and speed up the support for the EU's green and digital transitions but, at the same time, protect equal opportunities in the single market. The GBER's targeted amendment is aimed at making it easier for the Member States to grant necessary support for key sectors in accordance with the 'Green Deal Industrial Plan for the Net-Zero Age'[42] The GBER's targeted amendments by the Commission were formally adopted 23 June 2023.[43]

The GBER update from 23 June 2023 entails that more tax incentives with the aim to promote the green transition will be accepted compared to the situation before June 2023. Hence, the Member States have greater leeway for implementing tax incentives for promoting the green transition than before.[44] However, it is important to keep in mind that, if a state aid measure (e.g., a tax incentive) does not meet the GBER criteria, it does not mean that it is automatically incompatible with the EU state aid rules. It only means that the measure must be notified (prior to its implementation) to the Commission that will then assess whether it can be approved under other EU state aid rules. It can be deduced from Article 107 TFEU's structure that its paragraph (3) introduces the possibility for the European Commission of derogating, in certain specific cases, from the prohibition of aid that would otherwise be incompatible under Article 107(1) TFEU.[45]

Under the discussion of state aid rules and whether TFEU may limit the Member States in designing tax incentives to promote the green transition, it is also worth mentioning that there are various *de minimis* regulations that are relevant to take into consideration.[46] The thresholds in the form of amount and other requirements are different in the various *de minimis* regulations.[47] If the threshold for the *de minimis* rule is met, the aid is not considered to be state aid under Article 107 TFEU et seq.[48]

4.2.2 *TFEU Article 107(3)(C): Balancing Test*

4.2.2.1 In General

In the situation when aid falls outside the GBER's scope, new aid must be notified to the Commission for approval, cf. Article 108(3) TFEU, and Member States must wait for its decision before they can effectuate the measure. New aid may be compatible with the internal market if it falls under the scope of Article 107(3) TFEU which lists some aid measures that may be considered compatible under Article 107 TFEU. In relation to the question of the leeway of Member States to implement tax incentives to speed up the green transition, it is especially Article 107(3)(C) TFEU that is relevant. It holds that the Commission may find aid measure compatible if it happens to 'facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest', which is most relevant.[49]

In order for the Commission to determine whether an aid measure, for example, a tax incentive aimed at speeding up the green transition, is compatible with Article 107(3)(C) TFEU and thus is not prohibited under the TFEU as

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[40] State aid: Commission amends General Block Exemption rules (europa.eu) (accessed 1 Sep. 2024). Press release from 9 Mar. 2023. In relative terms, although more than 90% of all new state aid measures from the Member States are implemented under the GBER regulation, the amount of state aid under the GBER is often relatively small compared to the remaining 10% of state aid i.e., notified and accepted by the Commission under TFEU Art. 107 which is often relatively sizable.

[41] B. Pérez Bernabeu, *R&D&I Tax Incentives in the European Union and State Aid Rules*, 54 Eur. Tax'n. 5 J Articles & Op. Pieces IBFD. s. 3.3 (2014), doi: 10.59403/2nafw4v (accessed 23 May 2024).

[42] COM/2023/62 final. A Green Deal Industrial Plan for the Net-Zero Age EUR-Lex – 52023DC0062 – EN – EUR-Lex (europa.eu) (accessed 1 Sep. 2024). *See also* state aid: Commission amends General Block Exemption rules (europa.eu) (accessed 1 Sep. 2024). Press release from 9 Mar. 2023.

[43] Commission Regulation (EU) 2023/1315 of 23 Jun. 2023 amending Regulation (EU) No 651/2014. Regulations – European Commission (europa.eu) (accessed 1 Sep. 2024).

[44] It may be a bit overwhelming for the Member State to acquire sufficient knowledge for exactly seeing the leeway they have in relation to tax incentives aimed at promoting the green transition. Some may perhaps argue that the GBER has become a nightmare. It was once a Hemingway novel; it has now become Ulysses.

[45] René Barents, *Directory of EU Case Law on State Aids* 332 (Third ed. 2019).

[46] *See* e.g., Commission Regulation (EU) 2023/2831 of 13 Dec. 2023 on the application of Arts 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid. (Regulation – EU – 2023/2831 – EN – EUR-Lex (europa.eu)) (accessed 1 Sep. 2024).

[47] In Commission Regulation (EU) 2023/2831 of 13 Dec. 2023 on the application of Arts 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid that exempts small aid amounts from the scope of EU state aid control because they are deemed to have no impact on competition and trade in the internal market, as from 1 Jan. 2024, the ceiling per company is, e.g., EUR 300,000 over a three year period.

[48] Such rules, however, must still be in conformity with the fundamental freedoms of the TFEU and the EEA Agreement. Due to the scope of this article, this issue is not further analysed.

[49] *See also* Craig & de Búrca, *supra* n. 33, at 910.

unlawful and/or incompatible state aid, the Commission will undertake a 'balancing test'. It is an overall evaluation for which several principles are relevant to take into consideration with the Commission 'weighting positive effects in terms of a contribution to the achievement of well-defined objectives of common interest and negative effects of trade and competition in the common market'.[50]

As part of the European Commission's 2012 state aid modernization programme,[51] the Commission developed what is referred to as 'common assessment principles' for considering whether aid could be authorized under Article 107(3) TFEU. One of their aims was to bring greater consistency and a more systematic approach to the manner in which the Commission would assess aid across different guidelines and frameworks in relation to TFEU Article 107(3)(C).[52]

The principles developed by the Commission in the 2012 state aid modernization program have broadly been included in the state aid guidelines published since that program[53] and by the CJEU.[54] The aforementioned program entailed that:

> in order for an aid measure to be compatible with the common market, the Member State must demonstrate that it contributes to a 'well-defined objective of common interest'; that there was a need for State intervention; that it is an appropriate policy instrument to address the objective of common interest; that it has an incentive effect on undertakings' behaviour; and that it is proportionate, avoids undue negative effects on competition and trade between Member States, and is transparent.[55,56]

In a landmark case from CJEU, Case C-594/18 P *Austria v. Commission (Hinkley Point C)*, the CJEU clarified the content of this overall evaluation and the importance of these principles in the balancing test. In brief, the case deals with three aid measures provided by the United Kingdom and Northern Ireland for Hinkley Point C nuclear power station. They were all aimed at securing the financing of the nuclear power station.[57] The countries notified the Commission in October 2013 and, in October 2014, it stated that the measures at issue constituted state aid within the meaning of Article 107(1) TFEU. The Commission, however, examined whether those measures could be declared compatible with the internal market pursuant to Article 107(3)(C) TFEU and concluded that they could.[58]

With an application lodged at the Registry of the General Court on 6 July 2015, the Republic of Austria brought an action for annulment of the decision from the Commission regarding the aid measures aimed at Hinkley Point C nuclear power station. The General Court upheld the decision from the Commission and rejected the ten pleas put forward by the Republic of Austria. However, the country was not satisfied with the decision by the General Court and appealed its decision to the CJEU. The conclusion by the CJEU in its thorough and lengthy decision was that the appeal by the Republic of Austria was dismissed. Hence, the decision by Commission accepting the aid measure granted by the United Kingdom and the Northern Irland in relation to Hinkley Point C nuclear power plant as lawful was correct.

The *Hinkley Point C* case, however, requires a substantial reconsideration of the Commission's previous approach to the balancing test in Article 107(3)(C) TFEU, and it is especially relevant in four principal respects:

– There is no requirement under the balancing test that the aid must be granted in 'common interest'[59] or that the aid is aimed at repairing a market failure;[60]
– state aid rules that, after the examination has proven to be contradictory to the EU rules on the environment, may never be lawful state aid;[61]
– under the balancing test, the Commission must check whether the aid is compliant with EU environmental law;[62] and
– the aid measure must be proportional.[63]

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[50] C(2017) 4237 final, 26 Jun. 2017, *State Aid SA.47144 (2016/N) – Sweden Tax Reduction of Employee Share Options*, https://ec.europa.eu/competition/state_aid/cases/267512/267512_1910282_73_2.pdf (accessed 1 Sep. 2024), para. 32. *See also* Craig & de Búrca, *supra* n. 33, at 910.

[51] COM(2012)209, para. 18. *See* generally, S. Edissen, *Common Interest as a Condition for State Aid Compatibility,* 4 EstAL 452 (2020), doi: 10.21552/estal/2020/4/7.

[52] *See* COM(2012)209, para. 18.

[53] *See* e.g., the Framework for state aid for research and development and innovation, the Guidelines on state aid for environmental protection and energy, the EU Guidelines for the application of state aid rules in relation to the rapid deployment of broadband networks and Guidelines on regional state aid for 2014–2020.

[54] *See* e.g., T-68/15, HH Ferries et al., Commission, 19 Sep. 2019, EU:T:2018:563, §212.

[55] Suzanne Kingston, *State aid and the European Green Deal: The Implications of Case C-594/18 P Austria v. Commission (Hinkley Point C)*, UCD Working Papers in Law, Criminology & Socio-Legal Studies Research Paper No. 6 / 2021 10, file:///C:/Users/A1010619/Downloads/ssrn-3808040.pdf (accessed 1 Sep. 2024).

[56] *See* COM(2012)209, para. 18.

[57] Case C-594/18 P *Austria v. Commission (Hinkley Point C)* para. 3.

[58] *Ibid.,* para. 5.

[59] *Ibid.,* para. 30.

[60] *Ibid.,* para. 68.

[61] *Ibid.,* para. 100.

[62] *Ibid.,* para. 45.

[63] *Ibid.,* paras 102–104.

In relation to the question of the compatibility of domestic tax incentives aimed at promoting the green transition, the *Hinkley Point C* case is relevant in the sense that the CJEU gives further guidance to the Commission on what it may and may not take into consideration in the balancing test in Article 107(3)(C) TFEU. One of the key and groundbreaking findings to be remembered from the judgment is that the Commission must always take into account he environmental impact resulting from the aid measures. In the author's view, this entails that domestic aid measures that promote the green transition, as a starting point, will be considered as positive in the overall evaluation in the balancing test.

4.2.2.2 The Principle of Proportionality

Without delving into a detailed analysis of the principles that may be taken into account by the Commission in the overall balancing test under Article 107 (3)(C) TFEU when determining whether a domestic tax incentive aiming at speeding up the green transition is lawful, it may be useful to make some high-level comments about the principle of proportionality. It is a complex principle, and the consideration of whether the aid measure is proportional may create difficulties in some circumstances in relation to domestic tax incentives.[64] The proportionality principle entails that the tax incentive must be designed in a way that its scope is limited to the minimum needed to induce the additional investment or activity by the undertaking(s) concerned. In brief, this means that the tax incentive aimed at promoting the green transition must be drafted in a way that the same result could not have been achieved with less aid.[65]

Under the proportionality test, also the potential negative effects on competition and trade are relevant. The tax incentives 'must be designed in such a way as to limit distortions of competition within the internal market. The negative effects have to be balanced against the overall positive effect of the measure [i.e., the tax incentive]'.[66] Further, the proportionality test should be undertaken based on an examination planned effect of the aid measure/the tax incentives at the time when the tax incentives were adopted.[67] It should not be founded on speculation as to the precedent effect of the decision that it is called upon to adopt or on other considerations relating to the cumulative impact of that aid and other aid plans that may arise in the future.[68]

Before the *Hinkley Point C* case,[69] it was common to require that the state aid measure had to aim at an objective of common interest in accordance with Article 107(3) TFEU. After this case, however, this is no longer a requirement.[70] Although there is not an obligation that must be fulfilled for an aid measure to be considered as lawful under Article 107(3)(C) TFEU, the fact that it is aimed at promoting the green transition and, for example, will help to achieve the Paris Agreement,[71] will be an argument advocating that the tax incentives are lawful according to Article 107(3)(C) TFEU.

Furthermore, the work performed by the Commission regarding green taxation also shows the importance and focus on a more sustainable future.[72] The objective to aim for a sustainable development of the Earth, including improving of the quality of the environment, is also included in the general object and purpose of the European Union stated in TFEU Article 3(3) and Article 3(5).[73] Hence, to the extent that the domestic tax incentive is drafted to promote the green transition, this will be an argument in favour of saying that the tax incentive is an aid that is lawful under Article 107(3)(C) TFEU.

4.2.3. *R&D, Tax Incentives and the Green transition*

RDI are important tools to be able to achieve the goal in the Paris Agreement, including aiming for a 55% reduction in greenhouse gas emissions by 2030 and becoming a climate-neutral continent by 2050.[74] However, tax incentives aimed at promoting its activities for speeding up the green transition must (similar to other tax incentives) be evaluated in accordance with the prohibition of state aid in Article 107 TFEU. On 27 June 2014, the European Commission set out a framework for state aid for RDI (2014/C 198/01) with further guidance in relation to the compatibility of state aid.[75]

Notes

64 *See* e.g., *ibid.,* paras 70–104 for an idea on how complex this evaluation can be in some situations.

65 C(2017) 4237 final, *supra* n. 50, para. 58.

66 *Ibid.*, para. 65.

67 Judgment of 20 Sep. 2017, Commission *v.* Frucona Košice, C-300/16 P, EU:C:2017:706, para. 70.

68 Case C-594/18 P *Austria v. Commission (Hinkley Point C)* para. 80.

69 *Ibid.*

70 This is also confirmed in, e.g., Case C-353/21 P Ryanair DAC.

71 https://www.un.org/en/climatechange/paris-agreement (accessed 1 Sep. 2024).

72 Green Taxation – European Commission (europa.eu) (accessed 1 Sep. 2024).

73 On this web page, the aims and values of the EU are listed in an easily accessible way, https://european-union.europa.eu/principles-countries-history/principles-and-values/aims-and-values_en (accessed 1 Sep. 2024).

74 European Commission, *supra* n. 10. *Taxation in Support of Green Transition, supra* n. 10.

75 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014XC0627(01) (accessed 1 Sep. 2024). *See also* Pérez Bernabeu, *supra* n. 41.

On 19 October 2022, the European Commission adopted a revised communication on state aid rules for RDI (2022 RDI Framework).[76] It sets out a guideline for the discretion that the Commission undertakes in Article 107(3)(C) TFEU. The revised RDI framework includes targeted adjustments (1) to simplify and reflect the experience gained from the application of the 2014 RDI Framework[77]; (2) to reflect regulatory, economic, and technological developments; and (3) to align the relevant rules to the current EU policy priorities such as the European Green Deal[78] and the Industrial[79] and Digital[80] Strategies.[81]

In relation to the green transition, the RDI framework thus aims at facilitating (RDI) activities and thus entails greater leeway for the Member States to implement tax incentives aimed at speeding up the green transition. The RDI framework further enables Member States, subject to certain conditions, to grant tax incentives to undertakings and the research community to carry out these activities and investments that will promote the green transition. In relation to tax incentives promoting it, it is interesting to note that the 'RDI Framework applies the principle of technological neutrality and thus relates to all technologies, industries and sectors to ensure that the rules do not prescribe in advance which research paths would result in new solutions for innovative products, processes and services'.[82]

The provisions of the RDI framework are complemented by the GBER that stipulates ex ante compatibility conditions on the basis of which Member States can implement state aid measures without prior notification to the Commission (*see* section 0 above). Section 4 of the GBER especially deals with aid for RDI. Further, the RDI framework should also be read in conjunction with the 'balancing test' in Article 107(3) TFEU, cf., section 4.2.2 above.

4.2.4 *Interaction Between TFEU Article 107(3)(C) and GBER*

In relation to the application of Article 107(3)(C) TFEU and GBER, a question arises whether the fact that a tax incentive with the aim to promote the green transition that falls outside the scope of the GBER may still be accepted under Article 107(3)(C) TFEU or the other way around. Stated otherwise, the question is whether the interpretation of the GBER provides any guidance on interpreting the balancing test in Article 107(3)(C) TFEU (and/or vice versa).

The GBER consists of relatively detailed and schematic rules, and the fact that the tax incentive falls outside its scope does not mean that they may not be acceptable under Article 107(3)(C) TFEU after an overall evaluation of the relevant principles under the balancing test. The interpretation of the balancing test under Article 107(3)(C) TFEU is based on an overall evaluation while the GBER consists of rules that are more strict and detailed. It can be deduced from, e.g., C-493/14 *Dilly's Wellness hotel*, for example, that it should be interpreted relatively literal. Hence, its interpretation and application are based on a more formalistic approach than Article 107(3)(C) TFEU for which the Commission undertook an overall evaluation.

Due to this difference, there might be situations in which a domestic tax incentive falls beyond the scope of the GBER but may still may be considered as a compatible aid under the balancing test in Article 107(3)(C) TFEU. However, the same does not apply the other way around. In a situation when the aid is incompatible under Article 107(3)(C) TFEU or another exemption in the TFEU, the aid may not be encompassed within the GBER and be considered as compatible with Article 107 TFEU.

4.2.5 *More Lenient in Interpretation of the Prohibition of State Aid Concerning Aid for Supporting the Green Transition*

Based on the above analysis of Article 107 TFEU, an interesting question in relation to using tax incentives to promote the green transition is whether there has been a development in the acceptance of tax incentives when the its aim is to speed up the green transition by the Commission. There has been an increased focus on sustainability and the environment in the latter years both within the European Union and the rest of the world. The Paris Agreement was signed in 2015 and adopted by 196 countries around the world to reduce global warming and build resilience to climate change.[83] Like the UN, the EU has set out ambitious targets in an attempt to effectively address climate change and foster a cleaner environment. The aim is to reduce greenhouse gas

Notes

[76] C(2022) 7388 final, *Framework for State Aid for Research and Development and Innovation*, 090166e5f2b2bc33(1).pdf (accessed 1 Sep. 2024).

[77] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014XC0627(01) (accessed 1 Sep. 2024).

[78] The European Green Deal – European Commission (europa.eu) (accessed 1 Sep. 2024).

[79] European industrial strategy – European Commission (europa.eu) (accessed 1 Sep. 2024).

[80] A Europe fit for the digital age – European Commission (europa.eu) (accessed 1 Sep. 2024).

[81] State aid: Commission adopts revised 2022 RDI Framework (europa.eu) (accessed 1 Sep. 2024).

[82] State aid: Commission adopts revised 2022 RDI Framework (europa.eu) (accessed 1 Sep. 2024).

[83] The Paris Agreement is a legally binding international treaty on climate change. It was adopted by 196 parties at the UN Climate Change Conference (COP21) in Paris, France, on 12 Dec. 2015. It entered into force on (4 Nov. 2016), https://www.un.org/en/climatechange/paris-agreement (16 Oct. 2023) (accessed 1 Sep. 2024).

emissions by 55% by 2030 and to become a climate-neutral continent by 2050 with a 'complete transformation of how we produce, consume, and move about'.[84]

Further, as mentioned above, a new version of the GBER was released in 2014 with specific rules for aid for environmental protection[85] and, as late as 23 June 2023, the GBER was amended with the purpose to facilitate and speed up the green and digital transition (the 'green deal GBER amendment'). In addition, its updated version and also the RDI framework from 2022 (*see* section 4.2.3 above) are in favour of accepting the use of more measures to achieve the green transition.

Based on this, there is no doubt in the author's view that the Member States have greater leeway to adopt tax incentives aiming at the green transition. The updated GBER includes more categories of aid that do not have to be notified which again means that more tax incentives promoting it may fit into categories in the GBER and are thus not considered as illegal state aid.

Further, EU's focus on sustainability, the environment, and the green transition will have the effect that the Commission *must* always take into account the environmental impact on the aid measures under the balancing test in Article 107(3)(C) TFEU, cf. the *Hinkley Point C* case. Additionally, it will be more willing to accept tax incentives aimed at promoting the green transition under Article 107(3)(C) TFEU. Stated otherwise, the author's impression is that the increased focus on the environment and the green transition entails that the Commission will need to use its wide discretion to a great extent to accept aid measures as long as they are advantageous for the environment and the green transition.

5 Future perspective

5.1 *What Could We Expect for the Future?*

There has been and is an increased focus both globally and within the European Union on sustainability and the environment. It is further necessary for countries to do something to achieve the goals set out in the Paris Agreement and the ambitious EU rules for achieving 'net zero' by 2050. Hence, there has been both amendments and changes to the GBER legislation and the guidelines giving Member States relatively substantial discretion in terms of tax incentives aiming for the green transition that before would have been seen as unlawful state aid. However, both under the recent update of the GBER and the balancing test under Article 107(3)(C) TFEU, the tax incentives may be considered as lawful state aid.

As a consequence of this, the author hopes and believes that tax incentives will be used more in the future together with other tools and instruments for which the aim is to promote and speed up the green transition. For a Member State that considers implementing new tax incentives to achieve the goal of a more sustainable environment in its country, however, it is important to take into account the GloBe Pillar two rules when designing them.[86] Various types may have very different effects on calculating the effective tax rate under the GloBe Pillar two rules.[87]

If the author's analysis above is correct, a challenge with the increased use of tax incentives to promote the green transition is that it will be the legislators that design the tax incentives that, to some extent, will determine how the green transition will take place. The way tax incentives are designed will impact the direction that the green transition takes. Thus, it is left to the designers of the tax incentive to determine our 'green' future to some extent. However, the more broadly formulated the tax incentives are, the more that is left to the taxpayer to develop the best solutions. In such a situation, the legislature has afforded opportunities to the taxpayers to develop the best solutions for both the market and the environment.[88]

On the contrary, if the tax incentives are designed narrowly, it will be the legislature that determines the best solution for the green transition. One example that illustrates this is the tax incentives granted to electric cars in Norway (and not to all environmental friendly cars there).[89] As a consequence of this (and other benefits and incentives), 82.4% of all new passenger cars sold in Norway were fully electric.[90] In this latter situation for which the tax incentives are narrowly drafted, it may be questioned whether there is certainty that the legislators know best what the future would and should look like regarding tax incentives and the green transition. Alternatively, it is better that the market has a more active role in developing the green transition?

Notes

84 https://www.un.org/en/climatechange/net-zero-coalition,# (accessed 1 Sep. 2024).

85 *See* GBER s. 7 (Arts 36–49) that deals with 'aid for environmental protection'.

86 Global Anti-Base Erosion Model Rules (Pillar Two) | OECD (accessed 1 Sep. 2024).

87 *See* V. Chand & K. Romanovska, *The Impact of Pillar Two on Corporate Tax Incentives and Incentives Post Pillar Two – the Potential Rise of Tax Credits and Subsidies*, 6 Int'l Tax Stud. 9 J. Articles & Op. Pieces IBFD (2023), doi: 10.59403/1tywms8 (accessed 25 Aug. 2024) with further references.

88 This statement presumes that the market will act, in the long run, in a way i.e., best for the environment.

89 For a high level overview of the Norwegian car tax system, *see* Norwegian EV policy – Norsk elbilforening (accessed 1 Sep. 2024).

90 Norwegian EV market – Norsk elbilforening (accessed 1 Sep. 2024).

In summary, tax incentives are policy tools that can be invoked by Member States to promote investment, economic development, and innovation in the green transition which can have a significant impact on the environment and the future to a great extentHowever, there is also a need to find a sensible middle point between attracting investment and development and maintaining fair competition within the single market. This latter is secured by, among others, the state aid rules in Article 107 TFEU et seq.

5.2 *How to Compete With non-EU States' Use of Tax Incentives (e.g., the United States)*

The European Union and the EEA aims through the single market to be 'one of the most powerful trade blocs in the world on par with other global trade powers such as the US and China'.[91] However, to be able to compete with non-EU and non-EEA countries, it is important in the author's view that the Member States seize the opportunity to use the tool of tax incentives to attract businesses to further develop and push forward the green transition. There are examples in which corporations resident within the EU and the EEA have decided to establish and further develop their business within the net-zero industry in United States instead of within the EU/EEA because of its more beneficial tax incentives there.

It seems that the European Commission is aware of this. In its 23 June 2023 changes to the GBER to support its February 2023 'Green Deal Industrial Plan for the Net-Zero Age', it highlighted that '[t]he changes to the State aid framework to extend funding for net-zero industry should also be seen as a response to the cleantech-related investment incentives created by the US Inflation Reduction Act (IRA), offering new opportunities for companies to benefit from State aid and other financial support'.

In addition to the GBER's amendment, there is also an ongoing extensive work on the Net-Zero Industry Act (NZIA)[92] and the Critical Raw Materials Act (CRMA).[93] In March 2023, the Commission also published its position about the design and operation of the European Hydrogen Bank (EHB). It is intended to facilitate and support the production, import, and uptake of renewable hydrogen in the EU, and it published terms and conditions on 30 August 2023 for the upcoming EU Hydrogen Bank pilot auction.[94]

In addition to increase acceptance of tax incentives aimed at promoting the green transition, also other forms of aid are being used to achieve the net-zero goal in 2050. In the 'Green Deal Industrial Plan for the Net-Zero Age',[95] direct support and funding from both the Member States itself and/or the European Union are suggested to speed up the green transition:

> 4. More targeted aid for major new production projects in strategic net-zero value chains, taking into account global funding gaps. The draft TCTF would aim to ensure a level playing field with other jurisdictions and within the internal market, targeted to those sectors where a third-country delocalisation risk has been identified, and proportionate in terms of aid amounts. The TCTF would enable Member States to put in place schemes to support new investments in production facilities in defined, strategic net-zero sectors, including via tax benefits. (…) Member States can align their national fiscal incentives along a common scheme that the Commission stands ready to prepare, and thereby create a common scheme offering greater transparency and predictability to businesses across the EU.[96]

A key factor to achieving the aim of a green transition and meeting the obligations under the Paris Agreement and the ambitious goals under the EU net-Zero plan is funding. As mentioned in section 1 above, the green transition will be expensive, and there are estimates that suggest that the EU will need approximately EUR twenty-two trillion of investment from the private sector between 2021–2050 to achieve the goals for it.[97] There is a significant number of disparities within the EU in terms of support by Member States: 'For example, while in 2020, 0.57% of EU GDP

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91 European Parliament, *30 Years of EU Single Market: Benefits and Challenges* (16 Jan. 2023), https://www.europarl.europa.eu/topics/en/article/20230112STO66302/30-years-of-eu-single-market-benefits-and-challenges-infographics (accessed 1 Sep. 2024).

92 On 27 May 2024, the European Commission announced the final adoption of the NZIA (the regulation still needs to be published in the Official Journal of the European Union which was expected to happen by the end of Jun. 2024). 'The Net-Zero Industry Act is an initiative stemming from the Green Deal Industrial Plan which aims to scale up the manufacturing of clean technologies in the EU. This means increasing the EU's manufacturing capacity of technologies that support the clean energy transition and release extremely low, zero or negative greenhouse gas emissions when they operate. This Act will attract investments and create better conditions and market access for clean tech in the EU'.https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/green-deal-industrial-plan/net-zero-industry-act_en (accessed 1 Sep. 2024).

93 https://single-market-economy.ec.europa.eu/sectors/raw-materials/areas-specific-interest/critical-raw-materials/critical-raw-materials-act_en (accessed 1 Sep. 2024).

94 https://www.nortonrosefulbright.com/en/knowledge/publications/b01d19d5/eu-scales-up-green-subsidies-how-you-can-benefit-from-new-support-for-clean-investments (accessed 1 Sep. 2024).

95 file:///C:/Users/A1010619/Downloads/taxation%20in%20support%20of%20green%20transition-KP0620162ENN.pdf (accessed 1 Sep. 2024).

96 https://commission.europa.eu/system/files/2023-02/COM_2023_62_2_EN_ACT_A%20Green%20Deal%20Industrial%20Plan%20for%20the%20Net-Zero%20Age.pdf (accessed 1 Sep. 2024), at 9.

97 https://taxfoundation.org/research/all/eu/eu-green-transition-tax-policy/#tax (accessed 1 Sep. 2024).

was allocated to support renewable energy sources, one country allocated almost 1% of its GDP and ten others spent less than half the EU average'.[98]

The European Union is aware of this and, in COM (2023) 62 final, A Green Deal Industrial Plan for the Net-Zero Age, the Commission has included a plan for how the Member States and the European Union could and should finance the green deal transition.[99] (A further discussion of the financial issues in relation to the green transition falls outside the scope of this article.)

Based on the above, it is the author's impression that the European Member States seem to be well equipped and have the necessary tools to compete with other major markets such as China and the United States; they just have to use the tools that are available.

5.3 *Final Comment*

As a final comment, the author would like to highlight that there has been an important development within EU and the EEA in the direction of accepting more aid measures that promote the green transition. Furthermore, the EU and EEA countries should take the opportunity to implement (more) tax incentives that speed up the green transition. How to design the best suitable ones for doing so is a question of '[s] triking the right balance between various and often conflicting interests',[100] and this is a key challenge for future policy making. Further, it is also important for countries that consider implementing tax incentives not to try to not waste time and attempt to create something that already exists but look at but look at what other countries have done for inspiration and imitate their good practice.

There is haste for fulfilling the goals under the Paris Agreement. The Member States should use tax incentives as one of several other tools to achieve this goal, and the state aid rules both under the TFEU and the EEA Agreement are not a hindrance for this to a great extent. It is important that the EU, the EEA Member States, and the taxpayers seize the opportunity and ensure that the goal in the Paris Agreement is collectively achieved.

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98 'For example, while in 2020, 0.57% of EU GDP was allocated to support renewable energy sources, one country allocated almost 1% of its GDP and ten others spent less than half the EU average'. COM(2023) 62 final, *A Green Deal Industrial Plan for the Net-Zero Age*, https://data.consilium.europa.eu/doc/document/ST-5933-2023-INIT/en/pdf s. 2.2.2 (accessed 1 Sep. 2024).

99 COM(2023) 62 final, *ibid.*

100 European Commission, *supra* n. 10. *Taxation in Support of Green Transition, supra* n. 10, at 110.

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